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THE CURRENT ECONOMIC SITUATION AND TRENDS IN WESTERN EUROPE

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Summary

As the year 1962 nears an end, the rate of growth of business activity in Western Europe is leveling off at a pace which, although substantial, is considerably below the rates that prevailed during 1958-60. The outlook for the next 12 to 18 months is for continuance of the present rates of growth at 4 to 5 percent, based on an expectation of certain shifts in demand for European output, and an accompanying moderate deterioration in the balance of payments position of the major European countries that will bring a moderate improvement in the basic US balance of payments position.

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1. General Economic Trends

Stimulated by the completion of postwar recovery in Europe, rising incomes over most of the world, increasing demand for industrial products, and the imminence of a new tariff structure for the six countries of the Common Market, business activity in Western Europe rose rapidly after 1957. The average rate of growth of industrial production in Western Europe as a whole increased from less than 2 percent in 1958 to a remarkable 10 percent in 1960 (see Table 1*). The main impetus to growth came from a high level of investment activity within Europe (in part reflecting a move by US and other noncontinental industries to acquire productive assets behind the Common Market tariff wall) and from a rapidly rising level of exports both to

* P. 6, below.

other European countries and to the rest of the world, including the US (see Table 2*). In very large part, also, the high level of business activity was consciously promoted by government policies in Western Europe.

The rapid expansion of European exports during this period was traceable to the improved competitive position of Europe in world markets. Productive capacity was being modernized and expanded rapidly, and European prices remained relatively constant. Labor productivity in important sectors rose significantly as a result of the new capacity. In the larger continental countries, productivity rose more rapidly than did wages. Profits expanded, and prospects were bright. At the same time, rising US prices and sagging export efforts enabled European goods to compete more successfully with US commodities throughout the world.

The decline in the rate of growth of European industrial production that began in 1960 resulted from an expected decline in the volume of foreign investment in the Common Market countries, from declining rates of domestic investment as rising wages and less rapidly rising prices narrowed profit margins, and from a slowing pace in the growth of exports. Foreign investment, which had flowed to Europe in anticipation of the Common Market tariff wall, declined as large international companies acquired productive capacity on the Continent. The movement of private US capital into Europe reached a peak in 1960, reflecting the volume of direct investment by US corporations and of new foreign security issues marketed in the US. The flow of private US capital to Europe, although declining since 1960, remains high.

Since 1959, average prices in Europe have been rising. Furthermore, revaluation of the German mark and the Dutch guilder in March 1961 raised those countries' prices in terms of other currencies. Meanwhile the general level of US wholesale prices has shown no net change since 1958, and average prices of industrial commodities have been stable since 1959. The resulting improvement in the US competitive position has been accompanied by declining rates of export growth for European countries. The declining rate of increase in export volume has been due not only to more intense competition

* P. 7, below.

for world markets but also to rising consumer demand within Europe (see Table 3*). Rapidly rising wages coupled with a high level of employment apparently have permitted people throughout Europe to make effective a latent demand for a wide variety of consumer goods and thus have supported significant increases in living standards at all income levels.

2. US-European Trade

Trade between the US and Western Europe has reflected the divergent growth rates and price trends that have characterized the two large industrial areas since 1958. Between 1958 and 1960, when European industrial production was expanding rapidly, the US economy recovered only slowly from the 1958 recession. After 1960, however, as US economic activity quickened, the rate of European economic expansion declined. US exports to Europe changed little between 1958 and 1959, but in 1960 they increased by nearly 40 percent. At the same time, however, US imports from Europe increased by nearly 40 percent in 1959, but in 1960 they actually declined. In 1961, US exports remained at the high level of the preceding year ($6.3 billion), while US imports continued to decline, but by only 3 percent.

As a result of these changes, the US export surplus to Europe, which in 1958 was $1.2 billion and was eliminated in 1959, not only reappeared but was nearly doubled in 1960, reaching $2.1 billion. In 1961 this export surplus rose slightly, to $2.2 billion. During the first half of 1962, US imports from Europe again started to rise, and although exports continued upward, the more rapid import expansion caused a decline in the export surplus (see Table 4**).

3. Prospects

In the second half of 1961 the decline in European industrial growth leveled off from an average annual rate of 8 percent in 1958-60 to one of 4 to 5 percent, a rate that has been maintained thus far in 1962. The preponderance of economic opinion, both in the US and in Europe, expects the current rate of

* P. 8, below.
** P. 9, below.

sizable import surplus. Even under such conditions, however, dumping by European producers in the US market would be unlikely because of the buoyant conditions postulated for the US. In order for dumping in the usual sense -- that is, sales abroad below domestic prices and cost -- to be widespread, it would be necessary for markets both in Europe and in the US to be undergoing stagnation or contraction. Such conditions appear unlikely for the foreseeable future.

Although the slower pace of economic growth in Western Europe may result in some decrease in the value of US exports to the area, it seems likely that the over-all effect on the US balance of payments will prove to be beneficial. Exports to Europe are likely to remain high because European incomes are expected to rise and because reciprocal tariff reduction is expected to be followed by export expansion. Although rising US income will be accompanied by rising imports, as long as US prices remain competitive, imports will rise no more rapidly than income. Thus, if European and US incomes grow at roughly the same rate, and especially if tariff revisions are followed by expansion of exports, it seems likely that the US export surplus with Europe will remain at approximately the current level. Attracted by investment opportunities, US business in the past few years has made very sizable investments in Western Europe, contributing thereby to the US balance of payments deficit. The currently slower rate of economic growth in Western Europe, and particularly the slackening of planned investment activities, may be expected to reduce US exports of capital to the area, decreasing thereby the US balance of payments deficit on capital account.

Table 1

Rates of Growth of Industrial Production
in Western Europe
1957-62

Percent

	Europe	EEC a/	EFTA b/
Annual			
1958/1957	1.5	2.9	0.0
1959/1958	6.0	6.3	5.0
1960/1959	9.9	11.8	7.2
1961/1960	4.5	6.4	1.5
Quarterly (seasonally adjusted)			
1961/1960 (1st quarter)	5.2	7.1	1.5
1961/1960 (2nd quarter)	5.2	6.4	2.2
1961/1960 (3rd quarter)	3.8	4.6	2.2
1961/1960 (4th quarter)	3.1	5.6	0.0
1962/1961 (1st quarter)	4.3	6.1	0.7
1962/1961 (2nd quarter)	4.5	6.0	0.7

Source: Organization for European Cooperation and Development, Main Economic Indicators, August 1962.

a. European Economic Community.
b. European Free Trade Area.

Table 2

Annual Changes in the Level of Exports of Western European Countries 1958-62

			Percent
	OECD a/	EEC b/	EFTA c/
1958/1957	-0.5	+1.1	-2.4
1959/1958	+6.3	+11.0	+4.8
1960/1959	+14.3	+17.7	+9.0
1961/1960	+7.4	+8.8	+5.2
1962 (first half)/1961 (first half)	+6.3	+7.0	+4.7

Source: Organization for European Cooperation and Development, *Main Economic Indicators*, August 1962.

a. Organization for European Cooperation and Development.
b. European Economic Community.
c. European Free Trade Area.

Table 3

Annual Changes in the Level of Imports
of Western European Countries
1958-62

Percent

	OECD a/	EEC b/	EFTA c/
1958/1957	-6.6	-7.6	-6.0
1959/1958	+5.7	+5.5	+6.2
1960/1959	+18.4	+22.3	+15.3
1961/1960	+6.4	+8.6	+2.0
1962 (first half)/1961 (first half)	+7.1	+10.9	+2.7

Source: Organization for European Cooperation and Development, Main Economic Indicators, August 1962.

a. Organization for European Cooperation and Development.
b. European Economic Community.
c. European Free Trade Area.

Table 4

US Trade with Western Europe:
Value and Rate of Change
1958-62

	US Exports to Western Europe	US Imports from Western Europe	Net US Exports
	Billion Dollars		
1958	4.5	3.3	1.2
1959	4.5	4.5	Negl.
1960	6.3	4.2	2.1
1961	6.3	4.1	2.2
January-June			
1961	3.1	1.9	1.3
1962	3.3	2.3	1.0
	Annual Rates of Growth (Percent)		
1959/1958	0.5	37.2	
1960/1959	39.3	-7.5	
1961/1960	-0.4	-2.8	
January-June			
1962/1961	4.3	20.3	

Sources: Department of Commerce, WTIS Statistical Reports, Part 3, No. 61-11, and International Commerce, 8 October 1962

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ANNEX C

FRANCE

The French economy, in recent years, has shown remarkable strength and buoyancy. The average annual rate of growth of French GNP during 1950-60 was 4.3 percent, and official government policy, as set forth in the Fourth Plan of Economic and Social Development, establishes a growth target of 5.5 percent annually through 1965. The stimulus to growth has been especially strong since the revaluation of the French franc at the end of 1958, with the total increase in gross output from 1959 through mid-1962 amounting to about 30 percent.

There are signs, however, that the rate of growth in the second half of 1962 has slackened somewhat. The backlog of unfilled orders has decreased in the capital goods sector. The unusually high rate of growth of private investment has declined from 13.5 percent from 1960 to 1961, to 7.5 percent from 1961 to 1962. In spite of some isolated instances of lay-offs, most sectors of the French economy are still suffering from a shortage of both skilled and unskilled labor, and although the influx of foreign labor is expected to increase, shortages appear to inhibit business expansion. Nevertheless, the French economy is expected to continue to operate at a high level.

Although over-all French exports in the first 6 months of 1962 increased only about 2.9 percent compared with the corresponding period in 1961, exports to nonfranc areas registered an increase of nearly 11 percent. Over-all imports during the same period showed an increase of nearly 12 percent, with imports from nonfranc areas increasing only 8.6 percent. The continuing French export surplus contributed to a further improvement in the French balance of payments that permitted early repayment of French indebtedness to both Canada and the US.

With the French economy continuing to operate at near capacity, trade with the US is expected to remain at a high level. Some reduction must be expected in US exports of agricultural products, as French production -- stimulated by the protective features of the Common Market's agricultural policy -- increases and thereby reduces import requirements. At the same time, however, exports of machinery in 1963 may be expected to increase further as French industry continues to modernize and expand its plant. The high operating level of French industry should also ensure a rising demand for US exports of industrial raw materials, and continuing high consumer demand should permit increases in US exports of consumer goods.

ANNEX D

ITALY

Prospects for growth in the Italian economy continue bright in spite of the emergence of some uncertainties. The anticipated increase in GNP during 1962 is some 7 percent compared with 8 percent in 1961 and an average annual rate of 5.7 percent from 1950 to 1960. Industrial output is expected to increase an additional 11 percent in 1962, and agriculture and services are expected to continue their steady progress.

Postwar growth in Italian production has found a major stimulus in a rapidly expanding foreign demand. Exports increased by 155.7 percent from 1955 to 1961. Current signs of a decline in foreign demand would be viewed far more seriously were it not for sustained and rapid growth of the domestic market. A relatively high level of employment coupled with increased wages has sparked an increase in consumer demand for both goods and services. Investment has been maintained at a high level, and assurances of its continuation or acceleration are to be found in the variety of long-term programs for the development of Italian industry, communications, agriculture, housing, and the like. A final factor favorable to further expansion is the reportedly low level of current inventories throughout the industrial complex.

In spite of increasing labor costs, Italian industry should be able to maintain its competitive position in foreign markets in view of the fact that, at least until recently, productivity gains have outstripped wage increases and the wage scale still remains below that prevailing in the other industrialized Common Market countries. Italy's strong international reserve position, which already has made possible the advance repayment of several Marshall Plan loans as well as loans under the PL 480 program, is expected to continue.

Prospects for US trade with Italy would appear to be favorable, particularly with respect to exports of industrial materials and capital equipment in support of the Italian investment program. Although the full impact of the Common Market's agricultural policy instituted on 31 July of this year cannot be fully judged as yet, it is possible that US exports to Italy may benefit. Italian adoption of this policy will require the removal of quantitative restrictions on imports of certain US grains and poultry and thus the elimination of the largest remaining area of dollar discrimination.

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